KEJURUTERAAN BINTAI KINDENKO SDN BHD A

v.

NAM FATT CONSTRUCTION SDN BHD & ANOR

COURT OF APPEAL, PUTRAJAYA B
ZAINUN ALI JCA
RAMLY ALI JCA
ZAHARAH IBRAHIM JCA
[CIVIL APPEAL NO: W-02(IM)(NCC)-3609-2010]
22 JUNE 2011 C

CONTRACT: *Performance bond - Whether unconscionable for beneficiary to receive monies under performance bond - First respondent's call on performance bonds premature, invalid and mala fide - Whether unconscionability was ground for injunction to prevent call on unconditional 'on demand' performance bond - Standard of proof for unconscionability - Whether balance of convenience for grant of injunction favoured appellant* D

The appellant was appointed by the first respondent to carry out mechanical and electrical subcontract works for the integrated customs, immigration and quarantine complex in Johor Bahru. E
Both parties entered into an 'underlying contract' for the said works pursuant to which the appellant obtained in favour of the first respondent two bank guarantees from the second respondent bank for the due performance of the works. Differences between the appellant and the first respondent arose which led to the F
appellant filing an action coupled with an application in the High Court for an interlocutory injunction to restrain the first respondent from making a demand on the two guarantees. Despite the filing of the application the first respondent called on both G
guarantees. The parties then reached an accord that if the appellant obtained an extension of the validity period of both guarantees, the first respondent would immediately withdraw its demands. Though the appellant obtained the extension as agreed, the first respondent renewed its demands on the guarantees H
alleging that a breach of the underlying contract had occurred.

In the High Court the appellant said it had fully performed its obligations under the underlying contract as evidenced by the Certificate of Practical Completion issued by the Public Works Department as owner of the project. It was alleged the first I
respondent had acted unconscionably in calling on the guarantees as it had not fulfilled the condition precedent under cl. 24(c) of

A the underlying contract whereby a certificate had to be issued by the first respondent's employer to say the appellant had breached the underlying contract before a call on the guarantees could be made. The first respondent argued that the guarantees were unconditional 'on demand' performance bonds which the second B respondent was obliged to pay forthwith regardless of any contractual dispute between the parties. It was submitted that court intervention to stop payment on the guarantees was only permissible if there was fraud of which the second respondent had notice, and that unconscionability was not a ground to stop C payment.

The High Court dismissed the appellant's action and application for injunction. Against that decision the appellant appealed to the Court of Appeal. Although the High Court favoured the view that D 'unconscionable conduct' should be a ground to stop an abusive demand on a performance bond, the court felt it was bound by the Court of Appeal's decision in *LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor* to reject the appellant's case because there was no issue of fraud in the present case.

E The issue before the Court of Appeal was whether the beneficiary of a performance bond could be restrained from making a call on the bond on the ground of unconscionable conduct on his part and whether in the instant case the first respondent was guilty of F such conduct.

Held (allowing the appeal against the first respondent with costs and dismissing the appeal against the second respondent with costs)
Per Ramly Ali JCA:

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(1) The principle recognizing 'unconscionability' as a separate and distinct ground to restrain a beneficiary from making a call on a performance bond accorded with good commercial sense and was a sound principle which should be followed and adopted H by the courts in Malaysia. (para 91)

(2) The findings of the Court of Appeal in *LEC Contractors* were applicable to an injunction to restrain the bank/issuer from making payment out on an 'on demand' performance bond, not to an injunction to restrain the beneficiary from making a I demand on the bond. The court's judgment seemed to have been misinterpreted to mean that 'unconscionability' was not to be adopted as a distinct ground for the court's intervention.

Whereas, the court's focus there was on what did or did not constitute fraud and whether fraud had been pleaded or proved. (paras 87 & 88)

(3) A distinction must be drawn between an injunction to restrain a bank/issuer from making payment out on a performance bond (which is governed by the performance guarantee agreement) and an injunction to restrain a beneficiary from making a demand on the bond (which is governed by the underlying contract between the parties). (para 108)

(4) Both the bonds in the present case were unconditional and 'on demand' in nature. As against the second respondent no injunction could be granted to stop it from making payment out on the bond once a valid written demand was made by the beneficiary. (para 109)

(5) All the facts and circumstances surrounding the demands made by the first respondent on both the performance bonds were so lacking in good faith and amounted to unconscionable conduct that it warranted court intervention by way of injunction to avoid injustice. The demands on the bonds were premature, invalid and of no effect. (paras 79, 102 & 111)

(6) In order to rely on the ground of 'unconscionable conduct' to restrain an abusive call on a performance bond the plaintiff must show manifest or strong evidence of some degree of the conduct complained of; not a bare statement. The evidence need not necessarily be beyond reasonable doubt. The circumstances or conduct must be of such degree as to prick the conscience of a reasonable and sensible man. (paras 50 & 94)

(7) As the appellant's claim against the beneficiary exceeded RM32m and the guaranteed sums under the bonds totalled RM5m it was extremely unlikely the appellant would be able to recover RM37m from the beneficiary if it succeeded at the arbitration. The balance of convenience thus tipped heavily in favour of the appellant. (paras 106 & 107)

Per Zainun Ali JCA:

(1) The principle underlying the unconscionability doctrine was the prevention of oppression and unfair conduct; and because the determination of unconscionability was fact-specific, courts

must consider such a claim on a case by case basis and assess the totality of the circumstances and restrain a party from calling on the bond if the facts justified it. (paras 5 & 17)

Bahasa Malaysia *Translation Of Headnotes*

Perayu telah dilantik oleh responden pertama sebagai sub-kontraktor bagi menjalankan kerja-kerja mekanikal dan elektrik untuk kompleks bersepadu kastam, imigresen dan kuarantin di Johor Bahru. Kedua-dua pihak memeterai satu 'kontrak berlapis' bagi kerja-kerja tersebut, ekoran mana perayu telah memperoleh untuk manfaat responden pertama dua bank gerenti dari bank responden kedua bagi menyempurnakan projek. Pertikaian berbangkit antara perayu dan responden pertama yang mengakibatkan perayu memfailkan tindakan dan permohonan di Mahkamah Tinggi bagi suatu injunksi interlokutori bagi menghalang responden pertama dari membuat tuntutan terhadap gerenti. Walaupun permohonan ini difailkan, responden pertama telah membuat tuntutan terhadap kedua-dua gerenti. Pihak-pihak kemudian mencapai persetujuan bahawa, jika tempoh sah gerenti dapat dilanjutkan oleh perayu, responden pertama akan menarik balik tuntutannya. Perayu telah memperoleh lanjutan masa yang dimaksudkan, namun, responden pertama tetap meneruskan tuntutannya terhadap gerenti atas alasan telah berlaku kemungkiran terhadap kontrak berlapis.

Di Mahkamah Tinggi, perayu mengatakan bahawa ia telah melaksanakan semua obligasinya di bawah kontrak berlapis sepertimana yang terbukti dari Sijil Siap Praktikal yang dikeluarkan oleh Jabatan Kerja Raya selaku pemilik projek. Dikatakan juga bahawa responden pertama dalam memanggil gerenti telah bertindak secara tidak berhati perut, kerana tidak memenuhi syarat terdahulu fasal 24(c) kontrak berlapis, yang menyatakan bahawa suatu sijil yang menyatakan perayu telah melanggari kontrak berlapis perlu terlebih dahulu dikeluarkan oleh majikan responden pertama sebelum suatu tuntutan terhadap gerenti boleh dibuat. Responden pertama berhujah bahawa gerenti-gerenti merupakan bon pelaksanaan atas tuntutan yang tidak bersyarat, di mana responden kedua wajib membayarnya tanpa memperdulikan pertikaian yang berlaku di antara pihak-pihak. Dihujahkan lagi bahawa campurtangan mahkamah bagi menghalang pembayaran atas gerenti hanya boleh dibuat jika terdapat fraud yang disedari oleh responden kedua, dan bahawa kelakuan tidak berhati perut bukanlah suatu alasan bagi menghalang pembayaran.

Mahkamah Tinggi menolak tindakan dan permohonan perayu dan perayu merayu ke Mahkamah Rayuan. Walaupun Mahkamah Tinggi menerima pandangan bahawa 'kelakuan tidak berhati perut' adalah satu alasan untuk menghalang tuntutan bon pelaksanaan yang abusive, mahkamah merasakan bahawa ia terikat dengan keputusan Mahkamah Rayuan dalam *LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor* dan harus menolak permohonan perayu kerana tidak wujud apa-apa isu fraud dalam kes semasa.

Di hadapan Mahkamah Rayuan, isu yang berbangkit adalah sama ada benefisiari kepada suatu bon pelaksanaan boleh dihalang dari membuat membuat tuntutan terhadap bon disebabkan oleh kelakuan tidak berhati perut dan sama ada dalam kes semasa responden pertama telah berkelakuan dengan sedemikian rupa.

Diputuskan (membenarkan rayuan terhadap responden pertama dengan kos dan menolak rayuan terhadap responden kedua dengan kos)
Oleh Ramly Ali HMR:

(1) Prinsip yang mengiktiraf 'tidak berhati perut' sebagai satu alasan khusus bagi menghalang seorang benefisiari dari membuat tuntutan terhadap bon pelaksanaan mempunyai unsur komersial yang berguna dan merupakan suatu prinsip baik yang perlu diikuti dan diterimapakai oleh mahkamah-mahkamah di Malaysia.

(2) Dapatan Mahkamah Rayuan dalam *LEC Contractors* terpakai kepada injunksi bagi menghalang bank/pengeluar dari membuat bayaran ke atas bon pelaksanaan 'atas tuntutan', bukannya kepada injunksi bagi menghalang seseorang benefisiari untuk membuat tuntutan terhadap bon. Penghakiman mahkamah nampaknya telah disalahtafsir sebagai bermaksud bahawa 'tidak berhati perut' tidak harus diambil sebagai satu alasan bagi campurtangan mahkamah. Sedangkan, fokus mahkamah di situ adalah mengenai apakah yang dianggap sebagai fraud dan sama ada fraud telah diplid atau dibuktikan.

(3) Terdapat perbezaan di antara injunksi bagi menghalang bank/ pengeluar dari membuat bayaran atas bon pelaksanaan (dikawalselia oleh perjanjian jaminan pelaksanaan) dan injunksi untuk menghalang seorang benefisiari dari membuat tuntutan ke atas bon (dikawalselia oleh kontrak berlapis antara pihak-pihak).

A **(4)** Kedua-dua bon dalam kes semasa adalah tidak bersyarat dan bersifat 'atas tuntutan'. Setakat yang menyentuhi responden kedua, tiada injunksi boleh diberi bagi menghalangnya dari membuat bayaran di atas bon sebaik suatu tuntutan bertulis yang sah telah dibuat oleh benefisiari.

B **(5)** Kesemua fakta dan halkeadaan yang menyelubungi tuntutan yang dibuat oleh responden pertama atas kedua-dua bon pelaksanaan amat jelas tidak berniat baik dan merupakan kelakuan yang tidak berhati perut sekaligus mewajarkan campurtangan mahkamah bagi menghalang ketidakadilan. C Tuntutan terhadap bon-bon adalah pramatang, tidak sah dan tidak mempunyai kesan.

(6) Untuk bergantung kepada alasan 'kelakuan tidak berhati perut' bagi menghalang tuntutan bon pelaksanaan yang abusive, D plaintif harus menunjukkan keterangan yang jelas atau kukuh mengenai kelakuan yang disunguti; bukan pengataan kosong semata-mata. Keterangan tidak semestinya di luar keraguan munasabah. Halkeadaan atau kelakuan mestilah sebegitu rupa sehingga boleh menikam perasaan dan hatibudi seorang orang E munasabah dan berakal.

(7) Oleh kerana tuntutan perayu terhadap benefisiari melebihi RM32 juta dan jumlah yang digerenti di bawah bon berjumlah RM5 juta, maka ianya kelihatan amat sukar bagi perayu untuk F mendapat kembali jumlah RM37 juta tersebut dari benefisiari jikapun ia berjaya di dalam timbangtara. Imbangan keselesaan dengan itu amat ketara condong ke arah perayu.

Oleh Zainun Ali HMR:

G **(1)** Prinsip yang mendokong doktrin 'kelakuan tidak berhati perut' adalah untuk mencegah penindasan dan kelakuan tidak adil; dan oleh kerana pemutusan soal tidak berhati perut ini berkisar pada persoalan fakta, maka mahkamah hendaklah menimbang H tuntutan sedemikian berdasarkan keadaan sesuatu kes yang ada dihadapannya, menilai keseluruhan halkeadaan dan menghalang tuntutan ke atas bon jika fakta-fakta mewajarkannya.

Case(s) referred to:

American Cynamid Co v. Ethicon Ltd [1975] AC 396 ***(refd)***

I *Bocotra Construction Pte Ltd v. AG [1995] 2 SLR (R) 262* ***(refd)***

Bocotra Construction Pte Ltd v. Attorney General (No 2) [1995] 2 SLR 733 ***(refd)***

Chartered Electronics Industries Pte Ltd v. Development Bank of Singapore Ltd [1992] 2 SLR (R) 20 ***(refd)***

Commercial Bank of Australia Ltd v. Amadio and Another [1983] 46 ALR 402 ***(refd)***

Dauphin Offshore Engineering and Trading Pte Ltd v. The Private Office of HRH Sheikh Sultan Khalifa Zayed Al-Nahyan [2000] 1 SLR (R) 117 ***(refd)***

Deutsche Ruckversichening AG v. Walbrook Insurance Co Ltd & Ors [1995] 1 WLR 1017 ***(refd)***

Edward Owen Engineering Ltd v. Barclays Bank International Ltd & Anor [1978] 1 QB 159 ***(refd)***

Esso Petroleum Malaysia Ins. v. Kago Petroleum Sdn Bhd [1995] 1 CLJ 283 SC ***(refd)***

Focal Asia Sdn Bhd & Anor v. Raja Noraini Raja Datuk Nong Chik & Anor [2009] 1 LNS 913 HC ***(refd)***

Gammon Pte Ltd v. JBE Properties Pte Ltd (SCDA Architects Pte Ltd, third party) [2010] SGHC 130 ***(refd)***

GHL Pte Ltd v. Unitrack Building Construction Pte Ltd [1999] 3 SLR (R) 44 ***(refd)***

Harbottle v. National Westminster Bank [1978] QB 146 ***(refd)***

IE Contractors v. Lloyds Bank Plc and Rafidain Bank [1990] 2 Lloyd's Rep 496 ***(refd)***

Kvaerner Singapore Ltd v. UDL Ship building (Singapore) Ltd [1993] 3 SLR 350 ***(refd)***

LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor [2000] 3 CLJ 473 CA ***(refd)***

Lembaga Pelabuhan Johor v. Panglobal Insurance Sdn Bhd [1997] 2 CLJ Supp 531 HC ***(refd)***

Lloyds Bank v. Bundy [1975] QB 326 ***(refd)***

Min Thai Holdings Pte Ltd v. Sunlabel Pte Ltd & Anor [1999] 2 SLR 368 ***(refd)***

Patel Holdings Sdn Bhd Estet Pekebun Kecil Sdn Bhd & Anor [1989] 1 CLJ 229; [1989] 2 CLJ (Rep) 215 HC ***(refd)***

Potton Homes Ltd v. Coleman Contractors (Overseas) Ltd [1984] 28 Build LR 24 ***(refd)***

Raymond Construction Pte Ltd v. Low Yang Tong [1996] SGHC 136 ***(refd)***

Royal Design Studio v. Chang Development [1990] SLR 1116 ***(refd)***

Samwoh Asphalt Premix Pte Ltd v. Sum Cheong Piling Pte Ltd [2002] 1 SLR 1 ***(refd)***

Satriadesa Corporation Sdn Bhd v. Tenaga Nasional Bhd [2010] 4 CLJ 877 HC ***(refd)***

Shanghai Electric Group Co Ltd v. PT Merak Energi Indonesia & Anor [2010] 2 SLR 329 ***(refd)***

Tidal Marine Engineering Sdn Bhd v. Kerajaan Malaysia [2010] 1 LNS 1361 HC ***(refd)***

A **Legislation referred to:**
Companies Act 1965, s. 176(10)

Other source(s) referred:
Halsbury's Laws of England, 3rd edn, vol 17, 1956, p 682

B *For the appellant - Dato' Dr Cyrus Dass (Sanjay Mohanasundram & K Gobinath with him); M/s Kadir Andri & Partners*
For the 1st respondent - N Rajentharan; M/s GH Tee & Co
For the 2nd respondent - Hoi Jack S'ng; M/s Lee Hishammuddin Allen & Gledhill

C *[Appeal from High Court, Kuala Lumpur; Suit No: D-22-NCC-199-2010]*

Reported by Ashok Kumar

D

JUDGMENT

Zainun Ali JCA:

[1] I am in full agreement with my learned brother Ramly Ali, JCA in his judgment which have coherently set out the facts of this appeal and the rationale which is applicable therein.

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[2] The concept of unconscionability has steadily grown in stature and has had firm footholds in other jurisdictions.

F **[3]** In the past, judicial pronouncements went the way of fraud as being the only ground, in seeking an injunction to restrain a call on a performance bond. However recent judicial pronouncements have confirmed that unconscionability has a place in such circumstances, as an additional ground.

G **[4]** In my view, consonant with the principle as laid down by my learned brother, unconscionability is a doctrine which allows courts to deny enforcement of a contract because of abuses arising out of the contact.

H **[5]** In my view the principle underlying the unconscionability doctrine is the prevention of oppression and unfair conduct; and because the determination of unconscionability is fact specific, courts must consider such a claim on a case by case basis and assess the totality of the circumstances.

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[6] One such instance is found in the Singapore case of *Gammon Pte Ltd v. JBE Properties Pte Ltd (SCDA Architects Pte Ltd, third party)* [2010] SGHC 130. Where the court ordered the call on a performance bond to be deferred as a claim of unconscionability had been established.

[7] The facts are these. The plaintiff was engaged by the defendant (a developer) to construct a building. In the course of work, the defendant pointed out defects with the facade cladding of the building. The plaintiff undertook to rectify these defects.

[8] The architect engaged by the defendant to supervise the works issued the completion certificate certifying completion (completion certificate), which also enclosed a schedule of outstanding classes of defects. The plaintiff failed to remedy the outstanding defects, despite reminders. The defendant then called on the performance bond to fund the completion of the rectification work by another contractor, engaged by the defendant. The defendant claimed that it was justified in making the call on the basis that the outstanding sum due to it was S$1,820,198.59, which included a sum of S$1,200,800 as the cost of rectification of the cladding defects. The defendant claimed to have awarded the contract for the rectification works to Weng Thai Construction (WTC).

[9] Though the plaintiff did not dispute that there were outstanding defects, it alleged that it would be unconscionable for the defendant to call on the performance bond from a bank.

[10] The view taken by the court was that the plaintiff had established a strong *prima facie* case of unconscionability. The defendant's claim of S$2,200,800 claim for the rectification of cladding defects stood out like a sore thumb. In addition, the plaintiff alleged that she award to WTC was a share, where *inter alia*, there no time frame was specified in which to carry out the work in the letter of award, the method of rectification was also not specified. WTC's lack of expertise was confirmed when it showed inclination to appoint another entity to carry out the work. More importantly, the price of S$2,200,800 for the contract awarded to WTC was wholly out of proportion to the value of the works. In the circumstances, the concluded that WTC's tender price of S$2.2 million to repair some 83 relatively minor cladding defects was astronomical and grossly inflated so as to enable the defendant to justify the call on the full sum of the performance bond.

[11] It was also noted by the court that the total amount which the defendant claimed the plaintiff owed mainly for defective works amounted to more than 25% of the original contract value which the defendant awarded to the plaintiff to contract the entire buildings. It seemed strange that the architects issued a completion certificate when such a large amount of rectification works remained outstanding.

[12] The court thus ordered the call on the bond to be deferred until further order and for all rectification works to be completed by the plaintiff within six months.

[13] The defendant's appeal to the Court of Appeal in Singapore was dismissed. The Court of Appeal upheld the High Court's decision that the bond is question was not an unconditional on demand bond and that the plaintiff's claim of unconscionability had been established.

[14] We might also bear in mind the observation of Eveleigh LJ in *Potton Homes Ltd v. Coleman Contractors (Overseas) Ltd* [1984] 28 Build LR 24 at p. 28 where His Lordship said that:

> ... in principle I do not think it possible to say that in no circumstances whatsoever, apart from fraud, will the court restrain the buyer. The facts of each case must be considered. If the contract is avoided or if there is a failure of consideration between buyer and seller for which the seller undertook to procure the issue of the performance bond, I do not see why, as between seller and buyer, the seller should not be able to prevent a call upon the bond by the mere assertion that the bond is to be treated as cash in hand.

[15] I respectfully agree.

[16] Potion's case also reflected Eveleigh LJ's view that the "fraud" exception was not the only basis for an injunction to be granted in this situation.

[17] As it is, a performance bond is like a letter of credit and as such, the court should not be constrained from exercising its equitable jurisdiction and restraining the party from calling on the bond, if the facts justify it.

[18] Thus, for the unconscionability claim to prevail, the party alleging it must show specific facts which demonstrates lack of *bona fides* in the other party, showing the party had acted unconscionably.

[19] The duty of the court then is to balance the various factors, viewed in totality, in determining whether under the circumstances, allowing the call on the bond would be considered perfidious.

Ramly Ali JCA:

Introduction – The Appeal

[20] This is an appeal against the decision of the learned High Court Judge in dismissing the appellant's application for an interim injunction against the 1st respondent from making a demand on, receiving and/or utilizing the monies secured by two separate performance bonds (in the form of bank guarantees) no. TF 001G910928 and TF 001G901920, both dated 4 November 2008 issued by the 2nd respondent.

Factual Background

[21] The dispute relates to a project for the construction and commissioning of the integrated customs, immigration and quarantine complex in Johor Bahru. The parties involved in the dispute are:

(a) Jabatan Kerja Raya (JKR) – as the owner;

(b) Gerbang Perdana Sdn Bhd (GPSB) – as the employer;

(c) Nam Fatt Contruction Sdn Bhd – as the Main Contractor (the 1st respondent);

(d) Kejuruteraan Bintai Kindenko Sdn Bhd – as the Subcontractor (the appellant); and

(e) CIMB Bank Berhad (the 2nd respondent).

[22] The appellant was appointed by the 1st respondent, *vide* two separate letters of award dated 7 November 2003, to carry out the mechanical works for the project at an agreed contract sum of RM54 million; and the electrical works at an agreed contract sum of RM46 million. It was also agreed that the contract duration was for a period of two years and 15 days from 15 September 2003 (ie, to be completed by 30 September 2005).

[23] The appellant and the 1st respondent had thereafter entered into an underlying contract for the said works. Under cl. 24 of the Articles of Agreement (underlying contract) the appellant was

A required, as a condition precedent to commencement of the works, to provide performance bonds in cash or in the form of approved banker's guarantees in the sum equivalent to 5% of the total contract price, for the due observance and performance of the contract works.

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[24] For that purpose, the appellant had obtained two bank guarantees from CIMB Bank Berhad (the 2nd respondent), bearing nos. TF 1G901918 and TF 001G901920 respectively.

C **[25]** The appellant claimed that the contract works had been completed and the contract period was extended by a significant period of time. During the course of the works under the contract, there were disputes and differences between the appellant and the 1st respondent, particularly on the following issues:

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(a) the appellant's claim for prolongation costs of RM23 million;

(b) costs of variation works;

E (c) deductions made by GPSB from monies due and owing to the Appellant for liquidated damages amounting to RM3.675 million, and for rectification works; and

(d) refusal to grant further extension of time.

F **[26]** The 1st respondent on the other hand contended that the appellant itself had failed to observe and perform the subcontracts and had itself committed numerous breaches of its obligations under the subcontracts such as bad workmanship; outstanding works hampering interfacing works of other subcontractors; failure G to carry out and complete all outstanding works before the deadline set for the completion of handing over of the project; failure to provide adequate manpower to carry out the contractual obligations; delaying the mechanical and other remedial rectification works; incomplete underfloor trucking works and untrue reporting H on the progress of the works.

[27] On 3 February 2010, the appellant filed writ of summons against the 1st respondent for an injunction to restrain the 1st respondent from making demand on, receiving and/or utilizing the I monies secured by the two performance bonds issued by the 2nd respondent. On the same date, the appellant also filed an *ex parte*

application for an interlocutory injunction to the same effect. An amended writ of summons was filed on 1 July 2010 to include the 2nd respondent (CIMB Bank Berhad) in the suit.

[28] On 9 December 2010, the learned High Court Judge dismissed both the writ of summons as well as the appellant's *ex parte* application for an interim injunction with costs of RM10,000. Hence the present appeal.

[29] In the meantime, on 19 May 2010, despite the fact that an application for an injunction had been filed by the appellant, the 1st respondent proceeded to make a demand on both the performance bonds. No reasons were set out in this demand.

[30] The parties however reached an accord which was recorded by the learned High Court Judge on 26 May 2010. Based on the mutual terms of the said accord the appellant "shall by 7 June 2010 procure and obtain a letter duly issued by CIMB Bank Berhad in favour of the respondent to the effect that the validity period of each of the said two (2) bank guarantees has been extended from 1 June 2010 until 30 November 2011" and "that the respondent thereupon is to immediately withdraw their aforesaid demands made against the said two (2) bank guarantees". It was also agreed in the said accord that "in the event the appellant shall for any reason whatsoever fail to procure and obtain the letter of extension by 7 June 2010; CIMB Bank Berhad shall in the said circumstances be at liberty to release the bond monies under the two (2) said bank guarantees to the respondent forthwith."

[31] It is not in dispute that the appellant had fulfilled its part of the bargain as agreed in the said accord, ie, to procure and obtain an extension letter from CIMB Bank Berhad on the two (2) bank guarantees within the stipulated time. However, the 1st respondent did not withdraw their demands but rather issued further demands on 15 June 2010. This time, the demands were premised on the fact that there was an alleged breach of the terms of the underlying contract between the parties.

The Appellant's Contentions

[32] The appellant contended that the 1st respondent, in demanding for the sums guaranteed by the two (2) performance bonds was acting unconscionably on the ground that the 1st respondent and CPSB (the employer) had sought to engineer a

situation to avoid making payment of the sums due and owing to the appellant; the 1st respondent had also failed to either assess or claim for the monies due and owing to the appellant and thereby was in wilful disregard of its contractual obligations to the appellant; the 1st respondent had failed to take steps to pursue the appellant's claims for prolongation costs, variations and other claims for additional time and costs; and the 1st respondent had failed to properly assess the back charges imposed by GPSB (the employer).

[33] The appellant also contended that there was no breach of contract on its part in this case. The appellant claimed that it had duly completed its obligations under the underlying contract as evidenced by the Certificate of Practical Completion (CPC) issued by JKR. Therefore the appellant submitted that in making demands on the performance bonds, the 1st respondent had not fulfilled the condition precedent as set out in cl. 24(c) of the underlying contract ie, any demand on the performance bonds premised on a breach of the underlying contract can only be made after the Employer (GPSB) had issued to the 1st respondent (with a duplicate copy to the appellant) a certificate in writing stating in its opinion that the appellant has been in default. There is no such certificate issued by GPSB in the present case. The appellant submitted that "unconscionability" is sufficient ground to restrain the 1st respondent from making any demand on the performance bonds.

The 1st Respondent's Contentions

[34] The 1st respondent on the other hand, strongly denied all allegations made by the appellant. To the 1st respondent, the appellant itself had failed to observe and perform the contract and had itself committed numerous breaches of its obligations under the underlying contract.

[35] The 1st respondent strongly submitted that the two (2) performance bonds are unconditional "on demand" in nature, and as such the court should not be concerned with the contractual disputes between the parties relating to the underlying contract between them. The 1st respondent urged upon the court that the only exception allowed for court intervention to stop any payment on an "on demand" performance bond is fraud of which the bank has notice. "Unconscionability" is not a ground to stop such payment.

[36] The 1st respondent further contended that the bank is obliged forthwith to pay the 1st respondent on the two (2) performance bonds the amount specified in the demand notwithstanding any contestation or protest by the appellant or by any other third party and without proof or conditions.

Decision Of The High Court

[37] In dismissing the writ of summons as well as the *ex parte* application for an injunction the learned High Court Judge ruled that "Given the view I have taken as regards the decision of the Court of Appeal in *LEC Contractors*, which limits injunctive relief only to the fraud exception, and since this court is bound by this decision, the only proper order to make in this application is to dismiss it."

[38] The learned High Court Judge however felt that the ground of unconscionable conduct in making a demand on performance bond has sound commercial reasons and should be recognised as a separate ground to stop such demand. At pp. 17-19 of his grounds of judgment, the learned judge expressed the following view:

> It was also argued that attempt to obtain payment on the performance bond without the dispute between the parties being determined by arbitration or adjudication by the court, was made in a bad faith and was an unconscionable conduct to obtain unjust enrichment. I had occasion in *Focal Asia, supra*, which was a case concerning an alleged fraud on the call of the Bank Guarantee, to state as well that the ground of unconscionable conduct has sound commercial reasons in its support and in this regard the approach taken by the Singapore courts, which have recognised and applied unconscionable conduct as a separate ground to stop payment on a Performance Bond or Guarantee, is one that should be applied in Malaysia, unless constrained by higher authority. Having reevaluated and reconsidered the arguments and the decision in LEC Contractors, I must say I am constrained by this decision of the Court of Appeal such that in my view, despite the sound commercial reasons in favour of adopting the unconscionable conduct ground, it is not as yet open to the High Court to depart from the approach clearly expressed in LEC Contractors. There could however be situations where fraud and unconscionable conduct can overlap, but the overriding ground has still to be fraud which is brought to the notice of the Bank. To this extent, I share the same view stated by Mohamed Hishammuddin J (as

his Lordship then was) in *Pasukhas Construction Sdn Bhd & Anor v. MTM Millineum Holdings Sdn Bhd* [2009] 64 CLJ 480. See also the latest decision of Lee Swee Seng JC in *Nam Fatt Corporation v. Petrodar Operating Co Ltd & CIMB Bank (L) Ltd* (Suit No. S-22-315-2010) which adopts the same approach to the issue of fraud of which the Bank has notice being the only ground permissible.

In relation to unconscionable conduct as a ground, the courts in Singapore have been at the forefront of this development, and I take note that several recent High Court decisions in Malaysia have cited these cases and some have even adopted these persuasive authorities. See for instance *Nafas Abadi Holdings v. Putrajaya Holdings Sdn Bhd* (unreported), *Satriadesa Corporation Sdn Bhd v. TNB* [2010] 4 CLJ 877, *Radio & General Trading Co Sdn Bhd v. Wayss & Freytag* [1998] 1 MLJ 346, and the more recent decisions of Verghese George JC in *Tidal Marine Engineering Sdn Bhd v. Kerajaan Malaysia* (D-21NCC-19-2010), *MMN Bina Sdn Bhd v. Felda Properties Sdn Bhd* (D-24NCC-301-2010) and *Sumatech Engineering and Construction Sdn Bhd v. Malaysian Refining Company Sdn Bhd* (D-22NCC-123-2010).

[39] At p. 23 of his grounds of judgment, the learned judge concluded that "as I ventured to suggest earlier, these are sound commercial and policy grounds to support unconscionable conduct as a separate head of control, but I am bound by precedent, and the comments in Focal Asia have to be taken in this context."

The Issues

[40] The broad issues before this court are:

(a) whether a beneficiary of a performance bond can be restrained from making a call or demand on the said performance bond on the ground of unconscionable conduct on his part; and

(b) if the answer is in the affirmative, whether the conduct of the 1st respondent in the present case in calling or demanding for the performance bond amounts to unconscionable conduct on its part.

Definition And Scope Of "Unconscionability"

[41] The principle concerning "unconscionability" was initially propounded by Lord Denning in the case of *Lloyds Bank v. Bundy* [1975] QB 326 where it was held that unconscionable transaction between parties may be set aside by the court of equity. This

unconscionable category is said to extend to all cases where unfair advantage has been gained by an unconscientious use of power by a stronger party against a weaker (see also: *Halsbury's Law of England*, 3rd edn., vol. 17 [1956] at p. 682).

[42] On an application for relief against unconscionable conduct, the court looks to the conduct of the party attempting to enforce, or retain benefit of, dealing with a person under a special disability in circumstances where it is not consistent with equity or good conscience that he should do so. (see: *Commercial Bank of Australia Ltd v. Amadio and Another* [1983] 46 ALR 402).

[43] It was also held in that case *(Commercial Bank v. Amadio)* that "a transaction will be unconscientious within the meaning of the relevant equitable principles only if the party seeking to enforce the transaction has taken unfair advantage of his own superior bargaining power, or of the position of disadvantage in which the other party was placed. The principle of equity applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands."

[44] Mason J in the same case above ruled as follows:

> Historically courts have exercised jurisdiction to set aside contracts and other dealings on a variety of equitable grounds. They include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. In one sense they all constitute species of unconscionable conduct on the part of a party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience. But relief on the ground of "unconscionable conduct" is usually taken to refer to the class of case in which a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage.

[45] In the Singapore High Court, Lai Kew Chai J in the case of *Min Thai Holdings Pte. Ltd. v. Sunlabel Pte Ltd & Anor* [1999] 2 SLR 368 opined that "the concept of unconscionability involves

unfairness, as distinct from dishonesty or fraud, or conduct so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party."

[46] The scope of unconscionability was also elaborated in *Raymond Construction Pte Ltd v. Low Yang Tong* [1996] SGHC 136 as follows:

> … on the authorities considered, the court was elaborating on what would amount to unconscionability sufficiently grave and serious for equity to intervene. That proceeded on the basis that equity would step in to prevent the enforcement of any legal right if such enforcement would have been unjust.

[47] It is not possible to define "unconscionability" other than to give some very broad indications such as lack of *bone fides*. What kind of situation would constitute "unconscionable conduct" would have to depend on the facts of each case. This is a question which the court has to consider on each occasion where its jurisdiction is invoked. There is no pre-determined categorisation (see: *Dauphin Offshore Engineering and Trading Pte. Ltd. v. The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al-Nahyan* [2000] 1 SLR (R) 117; and *Shanghai Electric Group Co Ltd v. PT Merak Energi Indonesia & Anor* [2010] 2 SLR 329).

[48] Based on the above considerations, we are of the view that there is no simple formula that would enable a court to ascertain whether a party had acted unconscionably in making a call or demand on an "on demand" performance bond. In the final analysis, whether or not "unconscionability" has been made out is largely dependent on the facts of each case. In every case where "unconscionability" is made out, there would always be an element of unfairness or some form of conduct which appears to be performed in bad faith.

[49] In coming to this view, we have borne in mind the standard of proof required of the alleged "unconscionablity". In *Bocotra Construction Pte. Ltd. v. A.G.* [1995] 2 SLR (R) 262, the Singapore Court of Appeal, stated that "a higher degree of strictness applies, as the applicant will be required to establish a clear case of fraud or unconscionability in the interlocutory proceedings. It is clear that mere allegations are insufficient."

[50] In *GHL Pte Ltd v. Unitrack Building Construction Pte Ltd* [1999] 3 SLR (R) 44 the Singapore Court Appeal implicitly endorsed the strong *prima facie* standard propounded by the High Court in *Chartered Electronics Industries Pte Ltd v. Development Bank of Singapore Ltd* [1992] 2 SLR (R) 20. In that case, it was established that what must be shown is a strong *prima facie* case of "unconscionability", and not a bare statement or claim. There must be sufficient evidence to show that the circumstances or conducts are of such degree such as to prick the conscience of a reasonable and sensible man.

Position Of The Law In Malaysia

[51] The law in Malaysia on the issue as to whether "unconscionability" can be a ground to restrain a beneficiary from making a call or demand on an "on demand" and unconditional performance bond seems not to be very clear and certain.

[52] The Supreme Court in *Esso Petroleum Malaysia Ins. v. Kago Petroleum Sdn Bhd* [1995] 1 CLJ 283 held, *inter alia*, that since the performance bonds, in that case, were "on demand" performance bonds, they were independent of any underlying contract between Esso and Kago, all that was required to trigger them was a demand in writing and therefore it was not open to the judge to inquire into any breach of such underlying contract.

[53] In that case, the court held that no injunction could have been granted against Bank Bumiputra, the issuer of the performance bond on the ground that by applying the principle in *American Cynamid*, there would have been no serious question for trial in relation to the bank. However, the court further held that as between the contractor and the beneficiary, who are parties to the underlying contract, there is nothing to stop the contractor from applying for an interlocutory injunction to restrain the beneficiary from making a call on the performance bond in accordance with the underlying contract. Peh Swee Chin, FCJ at p. 291 of the judgment stressed as follows:

> However, in the instant appeal, the interlocutory injunction was granted not against Bank Bumiputra but against the beneficiary of the said performance bonds in an action against the same beneficiary, ie, the buyer, so that Bank Bumiputra was in effect similarly restrained, understandably for fear of the contempt proceedings. In our view, further, Bank Bumiputra was not a

party to the underlying contract or contracts between the buyer or seller. The right of the seller to the ancillary relief of an interlocutory injunction could arise out of such alleged invasion of the right of the seller ie, the plaintiff, by the buyer, ie, the Defendant, under the said contracts between the seller and the buyer. Therefore, despite the resulting effect that it would restrain Bank Bumiputra, it could not prevent the seller from applying for an interlocutory injunction.

[54] In *LEC Contractors (M) Sdn Bhd v. Castle Inn Sdn Bhd & Anor* [2000] 3 CLJ 473, the Court of Appeal at p. 497 held:

> When a Performance Bond is found to be an on demand Bond then no injunction could be obtained to stop the payment. There may be good grounds between the parties for injunction to apply but they would not be good to injunct the bank as can be seen in the case of Edward Owen where the injunction was set aside because the guarantee was an on demand Performance Bond. The only exception is in case of fraud which is brought to the notice of the Bank. ... Fraud must be specifically pleaded and proved. Mere allegation is not sufficient ...

[55] At p. 499, the court added:

> First of all we wish to point out that the authorities we have referred above clearly indicated that in order to justify any injunction to stop payment there must be clear evidence of fraud on the part of the 1st defendant which comes to the knowledge of the 2nd defendant. Bad faith or unconscionable conduct by itself is not fraud.

[56] The court (in *LEC Contractors*) further held in that case that an "on demand" performance bond is on similar footing as a letter of credit; and therefore a claim that there are "serious issues to be tried" cannot be used as a ground upon which a court can grant an injunction to stop a bank from making payment under a performance bond. The justice of the case or the balance of convenience test as propounded in *American Cynamid Co v. Ethicon Ltd* [1975] AC 396; [1975] 1 All ER 504 was in applicable in relation to an "on demand" performance bond.

[57] The position at the High Court level is quite uncertain. This was expressed by the learned High Court Judge in his grounds of judgment as cited above. Basically, in a number of High Court cases, the courts recognised that the ground of unconscionable conduct has sound commercial reasons to support an application to restrain the beneficiary from making a call or demand on a

performance bond. However the courts were of the view that they were constrained by the decision in *LEC Contractors* (by the Court of Appeal) to hold that such ground applies. The courts were constrained to hold that the only ground to stop such demand or payment is in case of fraud which was brought to the notice of the bank; and such fraud must be specifically pleaded and proved.

[58] In Singapore, the position is well settled. The decisions of the Court of Appeal Singapore in *Bocotra Construction Pte. Ltd. v. Attorney General (No. 2)* [1995] 2 SLR 733 and *GHL Pte Ltd v. Unitrack Building Construction Pte Ltd & Anor* [1999] SGGA 60 affirmed the principle that "unconscionability" on the part of the beneficiary in calling or demanding for payment on a performance bond is a separate and distinct ground apart from fraud for seeking injunctive relief (see also: *Samwoh Asphalt Premix Pte Ltd v. Sum Cheong Piling Pte Ltd* [2002] 1 SLR 1; *Min Tai Holding Pte Ltd v. Sun Label Pte Ltd* [1999] 2 SLR 368; and *Shanghai Electric Group Co. Ltd v. PT Merak Energi Indonesia & Anor* [2010] 2 SLR 329).

[59] In Singapore, instances where "unconscionability" was held to be applicable are:

a) where the beneficiary made a call based on a breach induced by their own default (*Kvaerner Singapore Ltd v. UDL Ship building (Singapore) Ltd.* [1993] 3 SLR 350);

b) where the beneficiary's call on the bond was based on delays in construction that were caused by the beneficiary's own default in failing to make timely payments on the interim certificates issued by the architect and a considerable sum due to the relevant account under the joint venture agreement was retained by the beneficiary (*Royal Design Studio v. Chang Development* [1990] SLR 1116); and

c) where the non-delivery of rice (the subject matter of the contract between the parties) was due to floods caused by typhoon and there was a 'force-majeure' clause in the contract (*Min Thai Holdings – supra*).

[60] What kind of situation would constitute unconscionability would have to depend on the facts and circumstances of each particular case (see: *Dauphin Offshore Engineering and Trading Pte Ltd v. The Private Office of HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan* [2000] 1 SLR (R) 117).

[61] A performance bond is basically a form of security for the performance of the underlying contract between the parties. Usually the underlying contract between the parties provides for the requirement of a performance bond to be issued by a bank for the benefit of the beneficiary in the event of non-performance of the other party of the contractual obligations between them. The underlying purpose of a performance bond is to provide a security which is to be readily, promptly and assuredly realisable when the prescribed event occurs, as stipulated in the underlying contract.

[62] On the one hand a beneficiary under a performance bond should be protected as to the integrity of the security he has in case of non-performance by the party on whose account the performance bond was issued. On the other hand, a performance bond can be used as an oppressive instrument. And in the event that a beneficiary calls on the performance bond in circumstance where there is *prima facie* evidence of fraud or unconscionability, the court should step in to intervene at the interlocutory stage to restrain him from making such a call until the whole matter has been investigated and determined (see: *GHL Pte Ltd v. Unitrack Building Construction Pte Ltd (supra)*).

[63] Besides providing for a requirement to have a performance bond, the underlying contract also provides for the circumstances or events under which the performance bond may be called by the beneficiary; the condition to be fulfilled before making such a call as well as the manner how the call may be made.

[64] A performance bond (or sometimes also called Performance Guarantee or Bank Guarantee) is issued by a bank or refutable insurance company (as the issuer). It is in the form of an undertaking by the bank (issuer) to forthwith pay the named beneficiary the amount specified therein, on the occurrence of an event specified.

[65] The status whether a performance bond is a conditional or unconditional on-demand in nature; whether the undertaking by the issuer is revocable or otherwise; whether it is to be paid notwithstanding any contestation or protest by any party; and the maximum amount guaranteed, must all depend on the wordings of the bond in question based on the intention of the parties ie, the issuer and the party who is required to provide for the

performance bond. Different performance bond may have different wordings in the guarantee document, thus having different effect in law. The guarantee agreement/document is signed by the bank (issuer) and the party who is required to provide for the performance bond. (The beneficiary who is a party to the underlying contract is not a party/signatory to the guarantee agreement).

[66] In the world of commerce, trustworthiness is a byword for doing business and performance bonds thus play a crucial role causing more business to be formed and to be transacted. They are the life-blood of domestic as well as international commerce. The undertakings by the issuer are regarded as collateral to the underlying contract between the underlying parties. It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by the issuer/banks (see: *Harbottle v. National Westminster Bank* [1978] QB 146; [1977] 2 All ER 862; [1977] 3 WLR 752).

[67] The real issue of a performance bond involves a straightforward exercise of construction or interpretation of the bond to discover the intention of the parties – per Sir Deny's Buckley in *IE Contractors v. Lloyds Bank Plc and Rafidain Bank* [1990] 2 Lloyd's Rep 496; [1991] 51 BLR 1.

[68] In short, matters relating to the requirement, issuance, calling and payment out of a performance bond involves two separate sets of transactions under two separate sets of contracts or agreements, namely:

a) a call or demand made by the beneficiary under the underlying contract between the beneficiary and the other party; and

b) payment made by the issuer or bank upon the demand made by beneficiary under performance bond or guarantee agreement.

[69] The underlying contract and the performance guarantee agreement, are two distinct and separate legal contracts/documents, which depending on their respective wordings can be dependent upon or independent of each other.

[70] In dealing with an application for injunctive relief (as in the present case) the court must, first of all, differentiate or distinguish whether it is to restrain the beneficiary from making a call or

demand on the performance bond; or to restrain the bank/issuer from making payment out of the performance bond to the beneficiary. If it is for the earlier one, the provisions of the underlying contract between the parties must be considered and cannot be disregarded. If for the latter, if the performance bond is on demand and unconditional in nature where it is provided that the issuer shall pay the beneficiary forthwith without proof or condition and notwithstanding any contestation or protest, then the bank/issuer is obliged to pay the beneficiary based only on the performance bond agreement without having to consider the underlying contract.

Injunctive Relief Against The Bank/Issuer

[71] The law on this issue is well-settled, locally as well as overseas: ie, if the performance bond is on demand and unconditional in nature, it is independent of any underlying contract between the parties; it is not open to the court to inquire into any breach of such underlying contract; and the bank/issuer is obliged to pay the beneficiary without any proof or condition, and notwithstanding any contestation or protest from any party. What is required is a valid demand in writing as stipulated in the guarantee agreement. Under such circumstances no injunctive relief can be granted to restrain the bank/issuer from making such payment to the beneficiary as demanded. The only exception to this rule is on the ground of fraud of which the bank/issuer has notice. The fraud must be on the performance bond itself and not the other documents. (see: *Esso Petroleum Malaysia Inc. (supra)*; *LEC Contractors (supra)*; and *Patel Holdings Sdn Bhd Estet Pekebun Kecil Sdn Bhd & Anor* [1989] 1 CLJ 229; [1989] 2 CLJ (Rep) 215).The question of "unconscionability" does not arise and should not be an exception to the rule.

[72] In the present case, both the performance bonds (Bank Guarantee No. TF 001G9019204 and Bank Guarantee No. TF 001G9019184 in respect of mechanical works package and electrical works package respectively) are dated 18 February 2004 with the validity period ending 30 September 2008. The expiry date of both the bonds was subsequently extended to 31 May 2010 with the last date for presentation of claims being 28 June 2010.

[73] The relevant parts of both of the performance bonds read as follows:

> 1) On the Guarantor's receipt of the contractor's first written demand, the Guarantor shall forthwith pay to the contractor the amount specified in such demand notwithstanding any contestation or protest by the nominated subcontractor or Guarantor or by any other third party and without proof or conditions. Provided always a total of all demands so made shall not exceed the sum of (RM2.7 million and RM2.3 million respectively) (Guaranteed Sum) and the total amount recoverable against the Guarantor under this agreement shall not exceed the Guaranteed Sum.

[74] On the face of it, and on the wording disclosed above, both the performance bonds appear to be couched as unconditional on-demand bonds. In the present case written demands in respect of both of the performance bonds were made by the beneficiary as stipulated under the two performance bonds. Therefore, the bank (ie, the 2nd respondent in the present appeal) is obliged to pay the beneficiary on the performance bonds if valid demands are made. No injunction can be granted to restrain the bank/issuer (2nd respondent) from honouring its obligation under both the performance bonds. The learned High Court Judge was right when he dismissed the appellant's application to restrain the 2nd respondent from making such payment on the performance bonds.

[75] Therefore, the appeal against the 2nd respondent (the bank/issuer) is without merit and is dismissed with costs.

Injunctive Relief Against The Beneficiary (The 1st Respondent)

[76] The existence of the performance bonds in dispute arose from the contractual relationship between the beneficiary (1st respondent) and the appellant where the 1st respondent was the main contractor and the appellant was a sub-contractor for the project for the Construction of the Integrated Customs, Immigration and Quarantine Complex in Johor Bahru. Their contractual relationship is governed by the underlying contract between them.

[77] The appellant was a sub-contractor for the project's two components, namely the mechanical and electrical works packages, with a total central value of RM100 million.

[78] The two performance bonds were issued pursuant to cl. 24 of the underlying contract whereby the appellant as the nominated subcontractor shall as a condition precedent to the commencement of works under the underlying contract, deposit with the 1st respondent as the main contractor a performance bond equal to 5% of the subcontract sum for the due observance and performance of the underlying contract. Clause 24(c) of the underlying contract provides:

> (c) if the Nominated Sub-contractor fails to execute the Sub-contract or commits breach of its obligations under this Sub-contract, the Contractor may utilise and make payments out of or deductions from the said Performance Bond, provided that the Contractor shall not be entitled to utilise such Performance Bond unless the Employer shall have issued to the Contractor (with a duplicate copy to the Nominated Sub-contractor) a certificate in writing stating in his opinion that the Nominated Sub-contractor has been in default as aforesaid.

[79] Thus, under cl. 24, of the underlying contract, the beneficiary (the 1st respondent) is only entitled to utilise the performance bonds if the nominated subcontractor (the appellant) fails to execute the contract or commits a breach of its obligations under the contract with one precondition which must first be fulfilled ie, that the Employer (Gerbang Perdana Sdn Bhd – GPSB) shall have issued to the 1st respondent (with a duplicate copy to the appellant) a certificate in writing stating in its opinion that the appellant has been in default. This precondition must be fulfilled before the beneficiary is entitled to make any call or demand on the said performance bonds. Unfortunately, in the present case, there is no evidence of any certificate issued by GPSB for that purpose. Therefore, under the underlying contract, the beneficiary is not entitled to make any demand on both the performance bonds. The demands are premature and they must be restrained from making such demands.

[80] The Supreme Court in *ESSO Petroleum Malaysia* did not restrain the court from issuing injunctive order restraining the beneficiary from making a demand or call on a performance bond in appropriate cases. Peh Swee Chin, FCJ in that case has indicated clearly that:

> The right of the seller to the ancillary relief of an interlocutory injunction could arise out of such alleged invasion of the right of the seller ie, the Plaintiff, by the buyer, ie, the defendant, under the said contracts between the seller and the buyer. Therefore, despite the resulting effect that it would restrain Bank Bumiputra, it could not prevent the seller from applying for an interlocutory injunction.

[81] There was nothing to suggest in that case *(Esso Petroleum Malaysia)* that fraud was the only ground to restrain the beneficiary from making a demand or call on a performance bond. There was also nothing to suggest that unconscionable conduct on the part of the beneficiary in making a demand or call cannot be a separate ground to restrain him from doing so. In fact, in that case, the Supreme Court applied the *American Cyanamid* principle and found that the balance of convenience tipped heavily against the seller (the beneficiary) and the remedy of the seller as plaintiff would be in damages. The interlocutory injunction granted by the trial court (in that case) in favour of the seller was discharged by the Supreme Court on the balance of convenience, without touching on the ground of "unconscionability" at all.

[82] In *LEC Contractors*, the Court of Appeal indicated as follows:

> when a performance bond is found to be an on demand bond then no injunction could be obtained to stop the payment. There may be good grounds between the parties to apply but they would not be good to injunct the bank as can be seen in the case of Edward Owen … The only exception is in case of fraud which is brought to the notice of the bank. This is not the case here. As can be seen from the statement of claim it pleaded bare allegations of fraud. No specific instances of fraud had been given. Fraud must be specifically pleaded and proved. Mere allegation is not sufficient.

[83] In that case, the Court of Appeal at p. 499 further held:

> First of all we wish to point out that the authorities we have referred above clearly indicated that in order to justify any injunction to stop payment there must be clear evidence of fraud on the part of the first Defendant which comes to the knowledge of the second Defendant. Bad faith or unconscionable conduct by itself is not fraud.

[84] The Court of Appeal relied on the case of *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd & Anor* [1978] 1 QB 159 where an injunction was set aside because the guarantee was an on demand performance bond. That case, involves an interim injunction restraining *Barclays Bank International* from paying to a beneficiary in Libya in respect of a performance bond guaranteeing the performance by the plaintiffs of an agreement for the supply of glasshouses. It was held in that case that:

> A performance guarantee was similar to a confirmed letter of credit. Where, therefore, a bank had given a performance guarantee it was required to honour the guarantee according to its terms and was not concerned whether either party to the contract which underlay the guarantee was in default. The only exception to that rule was where fraud by one of the parties to the underlying contract had been established and the bank had notice of the fraud. Accordingly, as the Defendants' guarantee provided for payment on demand without proof or conditions, and was in the nature of a promissory note payable on demand, and the Plaintiffs had not established fraud on the part of the buyers, the Defendants were required to honour their guarantee on the demand made by the Libyan bank. It followed that the judge had been right to discharge the injunction and that the appeal would be dismissed.

[85] The Court of Appeal (in *LEC Contractors*) also relied on the case of *Deutsche Ruckversichening AG v. Walbrook Insurance Co. Ltd & Ors* [1995] 1 WLR 1017 to support its findings on the issue of fraud. That case also involves an injunction to restrain a bank from making payment on a performance bond.

[86] At p. 499, the Court of Appeal (in *LEC Contractors*) concluded that "the authorities we have referred above clearly indicated that in order to justify any injunction to stop payment there must be clear evidence of fraud on the part of the 1st defendant which comes to the knowledge of the 2nd defendant. Bad faith or unconscionable conduct by itself is not fraud."

[87] That part of the findings of the Court of Appeal in *LEC Contractors* specifically refers to an injunction to restrain the bank/issuer from making payment out on an on demand performance bond, but not an injunction to restrain the beneficiary from making a demand or call on the performance bond. As stated earlier in this judgment, there is a distinction between an injunction to restrain a bank/issuer from making payment to the beneficiary

under an on demand performance bond and an injunction to restrain the beneficiary from making a demand or call on the performance bond. The first one is governed by the guarantee agreement issued by the bank/issuer while the second one is governed by the underlying contract between the parties, where the bank/issuer is not a party at all. Therefore, the above ruling by the Court of Appeal (on the issue of fraud and unconscionability) is not meant to be applicable to injunction restraining the beneficiary from making a demand or call on the performance bond. Even the Court of Appeal had indicated in that case that "there may be good grounds between the parties for injunction to apply but they would not be good to injunct the bank."

[88] The sentence "bad faith or unconscionable conduct by itself is not fraud" as appeared in the judgment of the Court of Appeal in that case seems to be misinterpreted to mean that "unconscionability" is not to be adopted as a distinct ground for the court's intervention. However, on a full reading of the decision (on the issue of fraud) one will find that the focus of the court appears to be on what constituted or did not constitute 'fraud' and whether it was pleaded and proved in that particular case.

[89] In this regard, this court is in full agreement with Varghese George, JC in the case of *Tidalmarine Engineering Sdn Bhd v. Kerajaan Malaysia* [2010] 1 LNS 1361 (unreported) where he said:

> The law in our jurisdiction might not be clear on "unconscionability" as a separate exception to the strict obligation to pay or receive monies when it involves on-demand/ unconditional bonds or guarantees. There has been some resistance to extend the position in Singapore laid out in *Bocotra*'s case to our shores.
>
> This is often attributed to one sentence in our Court of Appeal decision in *LEC Contractors (supra)* which reads:
>
> > Bad faith or unconscionable conduct by itself is not fraud.
>
> As I have noted in another decision of mine *(Sumatec Engineering and Construction Sdn Bhd v. Malaysian Refining Company Sdn Bhd)* our Court of Appeal may appear at first glance by that sentence to be averse to 'unconscionability' being received or adopted here as a distinct ground for the court's intervention. However I would beg to state, on a full reading of that decision, that the focus of the learned judges appear to be on what constituted or did not

A constitute 'fraud' and whether it was pleaded in that particular case. As is accepted in law, 'fraud' would no doubt encompass some element of 'criminality' or deceit. 'Unconscionability' on the other hand, would not necessarily always amount to 'criminal' acts. I am of the view that there is no justification, in principle or policy, why the same assistance of the court should be withheld from a party who approaches the court for intervention on the grounds of 'unconscionability' or *mala fide* acts on the part of the beneficiary, which if refused, could result in similar or more severe damage and loss to the aggrieved party would happen in a 'fraud' context.

[90] This court is also in agreement with Mohamad Ariff, J in *Focal Asia Sdn Bhd & Anor v. Raja Noraini bt. Raja Datuk Nong Chik & Anor* [2009] 1 LNS 913 where his Lordship made the following observations:

D The Singapore Court of Appeal in *Bocotra* … accepted the legal position that the court will grant an interlocutory injunction restraining a beneficiary from calling on the bond on the ground of fraud or unconscionability.

E In my view, the judicial and extra-judicial views expressed in Singapore accord with good commercial sense and unless precluded by higher authority and the doctrine of precedent, I am of the opinion that this viewpoint should be followed and adopted in Malaysia.

F **[91]** On the above authorities, this court is of the view that the principle recognising 'unconscionability' as a separate and distinct ground to restrain a beneficiary from making a demand or call on a performance bond, as adopted by the Singapore Court of Appeal case of *Bocotra Construction (supra)* accord with good G commercial sense and appears to be a sound principle; and therefore should be followed and adopted by the courts in Malaysia.

[92] A bold attempt was made recently by Prasad Sandosham H Abraham, JC in *Satriadesa Corporation Sdn Bhd v. Tenaga Nasional Bhd* [2010] 4 CLJ 877, where His Lordship granted an interlocutory injunction to restrain a claim or demand on a performance bond made by the beneficiary on the ground of unconscionable conduct on its part in rushing to make a call I shortly after the said performance bond had been renewed at its request. His Lordship followed the decision of the Court of Appeal (United Kingdom) in the case of *Elian and Rabbath (trading*

as Elian and Rabbath v. Matsas and Matsas); JD Mclaren and Company Ltd and Midland Bank Ltd (reported in *Lloyds Law Reports* 1966, vol. 2 at p. 495) in holding that, having looked at all the surrounding circumstances, the interest of justice calls for the intervention of the court to grant an injunction to prevent what might be irretrievable injustice, even where fraud is not pleaded.

[93] We all agree that performance bonds are used frequently in the construction industry as well as trade transactions locally as well as internationally. They are provided by and to parties who deal at arm's length. The court should give effect to the intention of the parties. The law in relation to performance bond should be placed on a clear and unambiguous footing so that they could be accepted by parties in Malaysia or at international level. Parties should not be allowed to take advantage of one another in making a demand or call on the performance bond particularly when they are not entitled to do so. It must be stressed that a performance bond can operate as an oppressive instrument and a demand or call by a beneficiary can sometimes be abusive. In the event that a beneficiary calls on the bond in circumstances where there is *prima facie* evidence of fraud or unconscionable conduct, the court should step in to intervene at the interlocutory stage to avoid further injustice to the other party. As has been expressed by the Court of Appeal in *GHL Pte Ltd v. Unitrack Building Construction Pte Ltd & Anor (supra)*, "we agree that a beneficiary under a performance bond should be protected as to the integrity of the security he has in case of non-performance by the party on whose account the performance bond was issued, but a temporary restraining order does not prejudice or adversely affect the security it merely postpones the realisation of the security until the party concerned is given an opportunity to prove his case."

Standard Of Proof Required

[94] In order to rely on the ground of 'unconscionability' to restrain an abusive call or demand made by a beneficiary on a performance bond, as a distinct and separate one apart from fraud, there must be placed before the court manifest or strong evidence of some degree in respect of the alleged unconscionable conduct complained of, not a bare statement. In this respect this court agrees with the learned High Court judge in his findings that "hence, the plaintiff has to satisfy the threshold of a seriously arguable case that the only realistic inference is the existence of fraud or unconscionability which would basically mean establishing

a strong *prima facie* case, at least at the interlocutory stage." The plaintiff has to place sufficient evidence before the court so as to enable the court to be satisfied, not necessarily beyond reasonable doubt, that a case of "unconscionability" being committed by the beneficiary has been established to an extent sufficient for the court to be minded to order the injunction sought. This additional ground should only be allowed with circumspect where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man.

The Beneficiary's Unconscionable Conduct In The Present Case

[95] There were a number of disputes between the parties before the demands or calls on the performance bonds were made by the beneficiary. The beneficiary (the 1st respondent) has failed to take steps to pursue the appellant's claims for prolongation costs, variations and additional time and costs. The beneficiary has failed to properly assess the back charges imposed by the employer (GPSB); and to challenge the imposition of damages for delay by GPSB on the appellant and to protect the right and interest of the appellant.

[96] The Appellant applied for an injunction on 3 February 2010. Thereafter, the beneficiary obtained a protection order under s. 176(10) of the Companies Act 1965 and as such the appellant could not pursue with the application. The beneficiary then, despite the fact that an application for an injunction had been filed by the appellant, proceeded to make demands on both the performances bonds on 19 May 2010. Apparently, the demands were made on the ground that the appellant had not extended the performance bonds that were expiring on 28 June 2010. There was a letter dated 31 March 2010 from the employer (GPSB) requesting for the performance bonds' validity period to be extended.

[97] The parties thereafter reached an accord which was recorded by the learned High Court Judge on 26 May 2010. Based on the terms of the accord, the appellant was supposed to extend the performance bonds which they did; and the beneficiary was supposed to withdraw the demands earlier made. The appellant's solicitors thereafter on 15 June 2010 requested the beneficiary to withdraw the demands earlier made on 19 May 2010. However, the beneficiary did not withdraw the said demands but instead issued further demands on 15 June 2010.

This time the demands were premised on the fact that there was an alleged breach of the terms of the underlying contract. The fact that the second demands were made after the appellant had extended the performance bonds based on a recorded accord between them clearly illustrates the lack of *bone fide* on the part of the beneficiary.

[98] "Therefore the rush to make a call on the bond shortly after it had been renewed by the plaintiff at the request of the defendant is conduct that could be construed as unconscionable. At any rate this conduct warrants further investigation" – per Prasad Sandosham Abraham JC in *Satriadesa Corporation Sdn Bhd v. Tenaga Nasional Bhd (supra)*.

[99] In making the demands, on both the performance bonds, the beneficiary has not fulfilled the condition precedent as set out in cl. 24(c) of the underlying contract between them, that any demand on the performance bonds shall be premised on a breach of the contract to which the employer (GPSB) shall have issued to the beneficiary (with a duplicate copy to the appellant) a certificate in writing stating in his opinion the appellant has been in default. No such certificate was ever produced in court. The appellant has duly completed its obligations under the contract as evidence by the Certificate of Practical Completion (CPC) issued by JKR (at p. 209 of exh. A7 p. 551 – appeal (records).

[100] In this regard, this court agrees with the ruling of the learned judge in *Lembaga Pelabuhan Johor v. Panglobal Insurance Sdn Bhd* [1997] 2 CLJ Supp 531 (at p. 535) where it was held:

> By looking into the contractual interpretation of the terms of the bond, a court has to see if there are any obligations on the part of the beneficiary to fulfil, notwithstanding the fact that the bond might seemingly be an unconditional or on demand bond.

[101] The calling of the performance bond by the beneficiary is subject to the terms of the underlying contract as agreed by the parties. It was pursuant to those agreed terms that the performance bonds were issued; and therefore any demand on the performance bonds must be in compliance with the terms of the contract (ie, in this case – cl. 24(c) of the underlying contract).

[102] On the above ground, the court is satisfied that the demands made by the beneficiary are invalid and of no effect; and must be restrained by an injunction.

[103] With regards to the performance bonds in respect of the electrical work component, the final draft account prepared by the employer (GPSB) illustrates that the appellant is owed monies. As such there is no basis for the beneficiary to issue the demand in relation to the related performance bond. In fact the learned High Court Judge in his decision has made a finding that it will be unconscionable for the beneficiary to make a call on the performance bond and that the call is abusive which should warrant court intervention. In his "conclusion" at pp. 26-27 of the grounds of judgment, he said:

> As regards the Performance Guarantee in relation to the electrical works component, however, the final draft account prepared by the employer (Gerbang Perdana) shows the Plaintiff is owed monies, not the reverse. It will be unconscionable to make a call on the Performance Guarantee on this. Hence on the evidence there is evident unfairness, though not dishonesty or fraud. It will however fall within the general rubric of conduct of a kind so lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party. This will be an abusive call on the relevant Performance Guarantee which should warrant court intervention without necessarily prejudicing the integrity of the security, pending the resolution of the dispute between the parties in the arbitration which has commenced.

[104] On the facts of the present case, this court agrees with the finding of the learned judge on this issue. Therefore, the related demand made by the beneficiary in relation to the electrical works package is clearly unconscionable and must be restrained.

[105] The overall facts and circumstances surrounding the demand made by the beneficiary on both the performance bonds (in relation to both the mechanical and the electrical works packages) in the present case shows that the demand is so lacking in good faith and amount to unconscionable conduct on the part of the beneficiary, which warrant court intervention by way of an injunction.

Balance Of Convenience

[106] In the dispute between the parties (which has yet to be resolved), the appellant has a claim in excess of RM32 million against the beneficiary. If the guaranteed sum under the performance bonds amounting to a total of RM5 million is paid to the beneficiary, this will mean that the appellant will have to

recover the sum of RM37 million from the beneficiary if the appellant wins at the arbitration. The beneficiary's financial position was in bad shape at the material time. This is because the beneficiary has sought a protection order under s. 176 of the Companies Act 1965. Under such circumstances, it would be extremely unlikely that the Appellant would be able to recover the amount from the beneficiary, even if the appellant wins the battle at the arbitration at a later stage.

[107] In this case, both of the performance bonds have been extended by the appellant, at the request of the beneficiary and the employer (GPSB). The right and interest of the beneficiary pursuant to the performance bonds is secured. Its right to call on the same is secured. On the other hand if the sums guaranteed under the performance bonds were to be released to the beneficiary, the appellant would suffer great losses and damage which cannot be adequately compensated; and the reputation of the appellant would be at stake. The balance of convenience thus tipped heavily in favour of the appellant.

Conclusion

[108] In summary, distinction must be drawn between an injunction to restrain a bank/issuer from making payment out of a performance bond (which is governed by the performance guarantee agreement) and an injunction to restrain a beneficiary from making a demand or call on the performance bonds (which is governed by the underlying contract between the parties).

[109] In the present case, both of the performance bonds are unconditional an on demand in nature. As against the bank/issuer (the 2nd respondent), no injunction can be granted to stop the bank/issuer from making payment out of the performance bond once a valid written demand is made by the beneficiary. Therefore, the appeal as against of the 2nd respondent must fail.

[110] As against the beneficiary (the 1st respondent), the principle of "unconscionability" as a distinct and separate ground to restrain the beneficiary from making a demand or call on the performance bond can be adopted and applied to the present case. The decision of the Supreme Court in *Esso Petroleum Malaysia (supra)*; and the decision of the Court of Appeal in *LEC Construction (supra)* can be distinguished so as not to affect the above rulings.

[111] All the facts and circumstances surrounding the demands made by the beneficiary (the 1st respondent) in respect of both of the performance bonds in the present case (in respect of both the mechanical works package as well as the electrical works package) are so lacking in good faith and amount to unconscionable conduct on part of the beneficiary which warrant court intervention by way of an injunction, to avoid injustice.

[112] On the above considerations, this court unanimously allowed the appeal against the 1st respondent (the beneficiary) with costs; and dismissed the appeal against the 2nd respondent (the bank/issuer) with costs.